DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date:	**Enrolled**	Bill No:	**Senate Bill 78**
Tax Program:	**Managed Health Care**	Author:	**Committee on Budget and Fiscal Review**
Sponsor:	**Author**	Code Sections:	**RTC**
Related Bills:		Effective Date:	**Immediately upon enactment**

This analysis only addresses the provisions that impact the Board of Equalization (BOE).

BILL SUMMARY

Among other things, this 2013-14 Budget trailer bill:

- Contingent upon specified federal participation and approval, imposes a 3.9375% sales tax on gross receipts derived from Medi-Cal managed care plans sold at retail in this state on and after July 1, 2013 to July 1, 2016, and
- Extends the insurance gross premiums tax on Medi-Cal managed care plans, from July 1, 2012, to July 1, 2013.

ANALYSIS

CURRENT LAW

Sales Tax. Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law[1] imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state or the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer.

California's sales and use tax rates. Effective January 1, 2013, California imposes a statewide 7.5% sales and use tax on tangible personal property sales and purchases. The table below shows California's various sales and use tax rate components (the table excludes voter-approved city and county district taxes):

Rate	Jurisdiction	Purpose/Authority
3.9375%	State (General Fund)	State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3)
1.0625%	Local Revenue Fund 2011	Realignment of local public safety services (RTC Sections 6051.15 and 6201.15)
0.25%	State (Fiscal Recovery Fund)	Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5)
0.25%	State (Education Protection Account)	Schools and community college funding (Section 36, Article XIII, State Constitution)

[1] Part 1 of Division 2 (commencing with Section 6001) of the Revenue and Taxation Code (RTC).

Rate	Jurisdiction	Purpose/Authority
0.50%	State (Local Revenue Fund)	Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2)
0.50%	State (Local Public Safety Fund)	Local governments to fund public safety services (Section 35, Article XIII, State Constitution)
1.00%	Local (City/County) 0.75% City and County 0.25% County	City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes
7.50%	Total Statewide Rate	

Insurance Tax. The California Constitution[2] imposes a 2.35% tax on insurers doing business in California. Commonly referred to as the "gross premiums tax," the annual insurance tax is based on insurers' gross premiums, less return premiums. The California Constitution specifies that the 2.35% tax is in lieu of all other taxes and licenses, with specified exceptions. Any person that meets this constitutional provision's "insurer" definition must register with the Department of Insurance (DOI) and remit the annual gross premiums tax.

Medi-Cal Managed Care Plans. As defined in the Constitution, "insurer" does not expressly include a health care service plan, such as a Medi-Cal managed care plan. The Knox-Keene Health Care Service Plan Act covers these providers. Therefore, these plans are not generally prohibited from other taxation.

Existing law[3] defines a "Medi-Cal managed care plan" to mean any individual, organization, or entity, other than an insurer or a dental managed care plan, that enters into a specified contract with the State Department of Health Care Services (DHCS), as described.

The "in lieu of" provision that currently exempts insurers from all other state and local taxes and licenses (with certain specified exceptions) does not apply to a Medi-Cal managed care plan. Accordingly, Medi-Cal managed care plans continue to be subject to other state, county, and municipal taxes and licenses, as applicable.

Until July 1, 2012, existing law[4] imposes a 2.35% annual tax on every Medi-Cal managed care plan doing business in this state. The tax revenues are remitted to the DOI, and are continuously appropriated to the DHCS for the Medi-Cal program in an amount equal to the difference between 100% and the applicable federal medical assistance percentage, with the balance appropriated to the Managed Risk Medical Insurance Board for purposes of the Healthy Families Program.

This Medi-Cal managed care plan tax is imposed on the "total operating revenues," which means all premium or capitation payments a Medi-Cal managed care plan receives for health care services, including, but not limited to, Medi-Cal services. Total operating revenues do not include amounts Medi-Cal managed care plans receive pursuant to a subcontract with a Medi-Cal managed care plan to provide Medi-Cal beneficiaries health care services.

[2] Article XIII, Section 28.
[3] RTC Section 12009.
[4] RTC Section 12201.

PROPOSED LAW

Among other things, this bill adds RTC Article 5 (commencing with Section 6174) to do the following:

- From July 1, 2013 until July 1, 2016, impose a 3.9375% sales tax on sellers of Medi-Cal health care services at retail, measured by the gross receipts from the sale of those services.
- For efficient administration of the tax, require sellers that are actively engaged in the retail sale of Medi-Cal health care services to register, report, and pay the tax to the BOE.
- Specify that sales tax prepayments shall not apply to sellers until no later than three months after the date that federal financial participation is available and any necessary federal approvals are obtained.
- Define "seller" to mean any person, other than specified insurers and dental managed care plans, or any entity that enters into a contract with the DHCS pursuant to specified provisions.
- Define "gross receipts" to mean the total premium or capitation payments Medi-Cal managed care plan sellers receive for health care services coverage or provision, including, but not limited to, Medi-Cal services. Excludes amounts received pursuant to a subcontract with a Medi-Cal managed care plan to provide health care services to Medi-Cal beneficiaries.
- Require the proposed tax revenues to be deposited in the State Treasury to the credit of the Children's Health and Human Services Special Fund.
- Prohibits counties, cities and districts from imposing a sales or use tax on the gross receipts described in the bill.
- Specifies that this article shall be implemented only if and to the extent that federal financial participation under specified federal law is available and any necessary federal approvals have been obtained. This article is automatically repealed if it is delayed based upon a challenge under federal law.
- Specifies that this article shall have no force or effect if there is a final judicial determination made by any state or federal court that is not appealed, in any action by any party, or a final determination by the administrator of the federal Centers for Medicare and Medicaid Services, that disallows, defers, or alters the implementation of this article.

The bill also makes numerous changes to the Tax on Insurers Law[5] to restore the 2.35% gross premiums tax on every Medi-Cal managed care plan in this state, from July 1, 2012 to July 1, 2013.

As an urgency bill, these provisions take effect immediately, but the imposition of the sales tax is contingent upon specified federal participation and approval.

IN GENERAL

Medi-Cal is California's Medicaid program. The DHCS's website describes Medi-Cal as a public health insurance program which provides needed health care services for low-income individuals including families with children, seniors, persons with disabilities, foster care, pregnant women, and low income people with specific diseases such as

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[5] Part 7, Division 2 of the RTC (commencing with Section 12201).

tuberculosis, breast cancer, or HIV/AIDS. The state and federal government equally finance Medi-Cal.

BACKGROUND

In 2009, Assembly Bill 1422[6] subjected the Medi-Cal managed care plans' total operating revenues to the 2.35% insurance gross premiums tax, until December 31, 2010. In 2010, Assembly Bill 853[7] extended the gross premiums tax on Medi-Cal managed care plans to July 1, 2011. Subsequently, Assembly Billx21[8] extended the sunset date to July 1, 2012. This Medi-Cal managed care plan tax expired July 1, 2012.

COMMENTS

1. **Sponsor and purpose.** This 2013-14 Budget trailer bill implements actions taken affecting the DHCS and the Managed Risk Medical Insurance Board.

2. **The State pays for the plans.** According to the Department of Finance, 24 managed health care plan providers will be subject to the proposed tax, and the State, rather than the beneficiaries pays the premiums for these plans. These 24 providers, who had been remitting the gross premiums tax to the DOI, will now be required to remit the 3.9375% sales tax to the BOE.

3. **Bill requires providers to report their tax obligations three times more frequently.** Currently, if the *annual* tax liability is $5,000 or more, Medi-Cal managed care plan providers are currently required to make quarterly prepayments to the DOI on or before April 1, June 1, September 1, and December 1.

   This bill requires these providers to file returns quarterly, generally by April 30, July 31, October 31, and December 31. However, if their taxable gross receipts average $17,000 or more per month (equal to a *monthly* tax liability of $4,794 or more, or $57,528 in tax annually[9]), the providers must, in addition to the quarterly returns, make two prepayments within each quarter.

4. **What if federal approvals occur after return or prepayment due dates?** The bill imposes the tax (it becomes operative) beginning on July 1, 2013. However, the bill specifies that the provisions shall be implemented only if and to the extent federal financial participation and approvals have occurred. If federal participation and approvals occur *after* the first tax reporting date, will sellers be subject to delinquency charges if they have not remitted the tax? Current law automatically imposes a 10% penalty on the late payment (6% for late prepayments) and 6% interest annually. Although penalty relief is available, the law[10] requires sellers seeking relief must file a statement under penalty of perjury setting forth the grounds for relief.

5. **Bill doesn't provide the BOE or affected sellers with much lead time.** Although the bill specifies that sales tax prepayments shall not apply to sellers "until no later than three months" after the date federal approval is obtained, the tax is implemented the date the federal approval is made. This provides virtually no time to enable the BOE to provide affected sellers with tax reporting and remittance instructions.

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[6] Ch. 157, Bass.
[7] Ch. 717, Committee on Health.
[8] Ch. 11, Blumenfield.
[9] $17,000 x 12 months x 2.35% = $4,794 per month x 12 months = $57,924.
[10] RTC Section 6592.

6. **The bill's language is patterned after similar in-home support services (IHSS) sales tax.** In 2009, legislation[11] was enacted to impose a sales tax on IHSS providers, measured by the providers' gross receipts from their services. Similar to this bill, this tax will only become operative if specified federal approval requests for matching funds are granted. To date, federal approval has not occurred, and the BOE has not yet implemented the tax.

7. **The BOE staff does not foresee any administrative problems with the gross premiums tax one-year extension.** The BOE, the Department of Insurance (DOI), and the Controller all contribute to the insurance tax administration. The Controller acts as a collector of any delinquent tax. The DOI primarily licenses, regulates, and audits insurers, and assesses and collects the tax amount each insurer is required to pay. The BOE issues DOI-determined assessments, makes refunds, and evaluates appeals.

   The one-year 2.35% Medi-Cal managed care plan tax extension will not change the BOE's responsibilities.

COST ESTIMATE

If the proposed sales tax is implemented, the BOE will incur administrative costs, estimated to be $495,000 during the first year, and $384,000 ongoing.

REVENUE ESTIMATE

According to the Senate Budget and Fiscal Review Committee, in 2012-13, the 2.35% gross premiums tax is projected to generate $166.4 million in revenue. The current year revenues of $125 million are directed to the Healthy Families Program and the remaining are directed to the Medi-Cal program for managed care rates for children, seniors and persons with disabilities, and others that reflect the cost of services and acuity of the population served.

In 2013-14 and beyond, the 3.9375% rate will generate about $340 million in revenues. These funds will offset General Fund expenditures for Medi-Cal managed care rates for children, seniors and persons with disabilities, and others.

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[11] AB 1612 (Ch. 725, Stats. 2009, Committee on Budget).